

Message Text

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ACTION EUR-12

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SUBJECT: EDRC ANNUAL ITALY REVIEW

REF: A. OECD PARIS 29404

B. ROME 16175 DATED NOVEMBER 19, 1974

C. ROME 16782 DATED DECEMBER 3, 1974

1. EMBASSY COMMENTS CONTAINED HEREIN ARE KEYED TO
PARAGRAPHS REF A.

2. OUTLOOK FOR 1975: EMBASSY SEES A FEW MORE REASONS
FOR HOPE THAN FOR QUOTE PRAYER AND DESPAIR END QUOTE
AS REPORTEDLY REFLECTED IN SECRETARIAT DOCUMENT. EMBASSY
AGREES WITH 1975 PROSPECTS IN ITALY OF DECLINING DOMESTIC
DEMAND, RISING UNUSED PRODUCTIVE CAPACITY, AND GRADUALLY
INCREASING UNEMPLOYMENT. WE ARE MORE OPTIMISTIC,
HOWEVER, THAT RATE OF INFLATION IN 1975 WILL
BE MODERATELY REDUCED AND THAT BALANCE OF PAYMENTS
DEFICIT WILL BE SIGNIFICANTLY LOWER THAN IN 1974.

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3. GROWTH OF OUTPUT AND DEMAND: EMBASSY CONCURS WITH SECRETARIAT FORECAST THAT ITALIAN ECONOMY IS ENTERING RECESSIONARY PHASE LATE IN 1974 AND CONTINUING IN 1975. GROSS FIXED CAPITAL FORMATION WILL PROBABLY DECLINE AND PRIVATE CONSUMPTION WILL BE FLAT. POSSIBILITY EXISTS THAT EXTERNAL DEMAND WILL TO SOME EXTENT OFFSET WEAK DOMESTIC DEMAND, ALTHOUGH THERE ARE LEGITIMATE DOUBTS ABOUT ADEQUACY OF GROWTH IN ITALY'S EXPORT MARKETS AND ABOUT ITALY'S ABILITY TO PROVIDE TIMELY PRODUCT DELIVERY SHOULD LABOR STRIKES ADVERESLY AFFECT PRODUCTION SCHEDULES.

4. OUTLOOK FOR PRICES. EMBASSY AGREES WITH SECRETARIAT ASSUMPTIONS OUTLINED PARA 4 REF A. ENCOURAGING SIGN IS RECENT PATTERN OF WHOLESALE PRICES, WHICH IN JULY-OCTOBER PERIOD ROSE DURING SUCCESSIVE MONTHS BY: 2.3, 1.9, 1.4 AND 1.1 PERCENT RESPECTIVELY. THIS IMPROVEMENT NOT YET REFLECTED IN CONSUMER PRICES, WHICH STILL INCREASING AT ABOUT 2 PERCENT PER MONTH IN SAME PERIOD. GOI REPS NOW PREPARING MEETINGS WITH LABOR LEADERS DURING NEXT FEW DAYS AS FIRST EFFORT OF NEW MORO GOVERNMENT AT COLLECTIVE BARGAINING. ATTITUDE OF LABOR UNIONS WILL BECOME CLEAR IN COURSE OF THESE MEETINGS. WE BELIEVE, ON BASIS OF REASONABLE LABOR/INDUSTRY AGREEMENTS IN AUTO SECTOR TO REDUCE WORK WEEKS OVER HOLIDAY PERIOD AND POSSIBLY THEREAFTER, THAT LABOR UNIONS ARE AWARE OF AND APPEAR ANXIOUS TO AVOID DANGERS OF RUNAWAY INFLATION FROM PRICE/WAGE SPIRAL, ESPECIALLY FOR FEAR OF EFFECTS ON EMPLOYMENT. UNIONS MAY SEEK STRICTER APPLICATION OF EXISTING SELECTIVE PRICE CONTROLS ON LARGE CONSUMPTIVE FOOD ITEMS OR EVEN AIM AT EXTENDING SUCH "POLITICAL PRICING" POLICIES.

5. POLICY MEASURES: NEW MORO GOVERNMENT ECONOMIC PROGRAM IN ESSENCE RESTATES RESTRICTIVE FEATURES OF FORMER RUMOR GOVERNMENT AND GIVES HIGH PRIORITY TO FIGHTING INFLATION AND REDUCING BALANCE OF PAYMENTS DEFICIT NOTWITHSTANDING EVIDENT DANGER OF RECESSION. WE FORESEE SOME SELECTIVE EASING OF CREDIT MEASURES IN 1975 TO STIMULATE INVESTMENT-- PARTICULARLY IN EXPORT SECTOR-- AND TO STIMULATE AGRICULTURAL AND HOUSING AND NON-RESIDENTIAL CONSTRUCTION. GOI HAS ALSO PREPARED CONTINGENCY ANTI-CYCLICAL PUBLIC WORKS PROGRAM LIMITED OFFICIAL USE

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(SEE REF B), ALTHOUGH NO COMMITMENT MADE TO IMPLEMENT PROGRAM AND DOUBTS EXIST ABOUT ABILITY TO DO SO IN TIME TO HAVE DESIRED ANTICYCLICAL EFFECT. ON BASIS OF EARLIER UNSUCCESSFUL EXPERIENCES, WE DOUBT THAT GOI WILL AGAIN ADOPT GENERALIZED PRICE FREEZE. WE ALSO RATHER DOUBT THAT INCOME SURTAX WOULD BE POLITICALLY ACCEPTABLE OR EVEN ECONOMICALLY DESIRABLE IN PRESENT SITUATION. SECRETARIAT'S CONCERN OF "PERMANENT PROTEST AGAINST THE SYSTEM" AS

INFLUENCING POSSIBLE INCOMES POLICY SEEMS QUITE EXAGGERATED. IN FACT, IT APPEARS POSSIBLE THAT GOI AND UNIONS MAY EVENTUALLY AGREE TO A FORM OF "SOCIAL CONTRACT" WHEREBY LABOR UNIONS LIMIT WAGE DEMANDS IN RETURN FOR VIGOROUS GOI COMMITMENTS TO FIGHT INFLATION SO AS TO PROTECT REAL PURCHASING POWER AND TO TAKE MEASURES TO LIMIT ADVERSE EFFECTS OF AUSTERITY PROGRAM ON EMPLOYMENT LEVELS.

6. BALANCE OF PAYMENTS. EMBASSY AGREES WITH COMMENTS PARA 6 REF A, ALTHOUGH WE THINK LIRA MAY BE ALLOWED TO GRADUALLY DEPRECIATE SOMEWHAT. STRONG POSSIBILITY EXISTS THAT GOI WILL SUCCEED IN ELIMINATING NON-OIL DEFICIT COMPLETELY BY END OF 1975 OR EVEN BEFORE. (TRADE DATA ON CUSTOMS BASIS FOR PERIOD JUNE-OCTOBER, WITH ROUGH ADJUSTMENT TO REDUCE IMPORTS FROM CIF TO FOB BASIS, ALREADY SHOW NON-OIL SURPLUS OF ABOUT \$190 MILLION.)

7. COMMENT: EMBASSY CONCURS WITH MISSION APPROACH OUTLINED PARA 7 REF A. MISSION ALSO MAY WISH TO POSE FOLLOWING ADDITIONAL QUESTIONS: A. WHAT ARE GOI INTENTIONS RE SELECTIVE EASING OF CREDIT TO SPUR INVESTMENTS IN EXPORT SECTOR, AGRICULTURE, CONSTRUCTION INVESTMENTS IN MEZZOGIORNO, ETC; B. DOES GOI FORESEE ADOPTING SELECTIVE INCREASES IN TVA RATES TO LIMIT DOMESTIC DEMAND AND REDUCE IMPORTS? C. WHAT ARE GOI INTENTIONS RE OFFSETTING EXPANSIONARY EFFECT OF RELEASE OF PRIOR IMPORT DEPOSITS? D. WHAT ARE PROSPECT FOR ACCEPTANCE OF GOI BY LABOR DEMANDS TO UNIFY COST OF LIVING ADJUSTMENTS AT PRESENT HIGHEST LEVEL? E. WHAT STEPS DOES GOI INTEND TO TAKE TO ACHIEVE STATED GOAL OF REDUCING ENERGY IMPORTS BY 10 PERCENT FROM 1973 LEVELS?, AND F. WHAT ARE GOI INTENTIONS REGARDING EMERGENCY PUBLIC WORKS PROGRAM? VOLPE

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